No. 15370

United States Court of Appeals
For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

vs.

MULTNOMAH OPERATING COMPANY, *Respondent*

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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JURISDICTION

The jurisdiction of this court is founded upon 26 USC, Sec. 7482, which provides:

"(a) Jurisdiction—The United States Court of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in Sec. 1254 in Title 28 of the United States Code, in the same manner and to the same extent as decisions of the District Courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari in the manner provided by Sec. 1254 of Title 28 of the United States Code."

"(c)(1) Upon such review such court shall have the power to affirm or, if the decision of the Tax Court is not in accordance with law, to modify or to reverse the decision of the Tax Court, with or without remanding the case for rehearing, as justice may require." . . .

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

"Sec. 23. DEDUCTION FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

"(a) Expenses.

"(1) Trade or Business Expenses.

"(A) In General—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of the trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, or property to which the taxpayer has not taken or is not taking title or in which he has no equity."

Regulations 111 Sec. 29.23(a)-6:

"*Compensation for personal services.*—Among the ordinary and necessary business expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. . . ."

"(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. . . ."

"(3) . . . The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date the contract is questioned."

STATEMENT OF FACTS

The parties stipulated the factual matter appearing at pages 25-40 of the record on appeal,[1] and the Tax Court adopted the stipulation as part of its findings. This material together with the other evidence contained in the record on appeal, can be summarized as follows to clarify what is at best a complex factual situation:

1. Multnomah Operating Co. (herein called Multnomah) was the eventual lessee of the Multnomah Hotel property (Ex. 2, R. 77). It is the corporation that made the payments here in question and that claims the deductions which the Commissioner seeks to have disallowed. Multnomah was incorporated about 1931 for the purpose of taking title to the leasehold estate and operating the Multnomah Hotel property. On July 1, 1931, its 250 shares of issued and outstanding capital stock were owned by 9 persons (R. 26). Among these were the following:

Name	*No. of Shares*	*Percentage of Total*
1. F. A. Dupar	17	6.8%
2. Maltby-Thurston Hotels, Inc. (herein called Maltby)	123	49.2%
3. Peter G. Schmidt (Trustee for Pacific Coast Investment Co., herein referred to as PCI)	62	24.8%

[1] References to pages 25-40 of the record on appeal are references on the Tax Court findings rather than evidentiary material as such, but are

The capital stock of taxpayer corporation was thereafter in large part deposited in a voting trust, and the beneficial ownership of the stock in that trust remained substantially unchanged during all times material to this case (R. 26). The total issued and outstanding stock during the period of the voting trust was held by an undisclosed number of shareholders, in any event more than the four who participated in the voting trust (R. 26). Included among these were:

Name	*No. of Shares*	*Percentage of Total*
1. F. A. Dupar	17	6.8%
2. Maltby	124	49.6%
3. PCI	61½	24.6%

2. Reference is made in the findings of the Tax Court and throughout the record, to three corporations other than Multnomah, which were involved in the over-all transaction. None of them is a party to this case, none paid any of the money in question, and none claims any income tax deduction. For the purposes of identification and clarity of analysis, these may be briefly described as follows:

(a) Maltby's relationship to taxpayer is that of stockholder and assignor of the leasehold under which taxpayer has held possession of the Multnomah Hotel property (R. 26, 42). The distribution of Maltby stock was scattered over 7 to 9 persons during the times material to this suit. Mr. F. A. Dupar was not a stockholder when the Multnomah lease was first signed. He acquired stock subsequent to 1944 in amounts that eventually totalled 3.5% of the oustanding stock (R. 27, 28).

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given as that part of the Tax Court findings as a recital of the stipulated facts.

(b) The relationship of PCI to taxpayer was solely that of stockholder (R. 26), and while it received a part of the payments here in question, its tax liability is in no way in issue. This corporation during the time in question had between 10 and 33 shareholders (R. 29, 30, 31). F. A. Dupar was never a stockholder in PCI. Maltby was not until 1944 when it acquired a substantial block of shares (R. 32).

(c) Western Hotels, Inc. (hereinafter called Western), neither paid nor received any of the money in question and its relationship with taxpayer was merely that of a management concern which furnished services to a number of hotel properties, including the Multnomah Hotel (R. 110, 140, 141). Its compensation for this service was in the form of fees paid by the hotels that use its services (R. 139, 140). Western has never held stock in taxpayer (R. 26). It was formed about 1930 by a group of hotel operators for the purpose of concerting their operations and resources (R. 28). When the Multnomah lease was first negotiated, Western had 21 stockholders. By 1944 and thereafter its stock was recapitalized and the issued and outstanding stock was owned 25% by F. A. Dupar, 25% by PCI and 50% by Maltby (R. 29).

3. At the time the events involved in this case began, the Multnomah Hotel was in serious financial difficulties and the prospects for immediate improvement of its business were poor (R. 105), it being in the depression of the 1930's. At that time Maltby, Dupar and PCI, who previously were "bitter competitors" became interested in the Multnomah Hotel property (R. 105). Maltby was represented by S. W. Thurston and PCI

by Peter G. Schmidt. The arrangement eventually worked out was to vest the leasehold in taxpayer corporation, which was formed for that purpose and for the purpose of operating the Multnomah Hotel. At the time of formation of taxpayer corporation, F. A. Dupar took 6.8% of the stock, PCI took 24.8% and Maltby took 49.2%, the balance being acquired by 6 other investors (R. 100, 26).

Negotiations for this lease were carried on by all three (Maltby, PCI and Dupar) the former being represented by Mr. Thurston and Mr. Schmidt, respectively, as stated above (R. 99). They negotiated continuously for between 10 months and a year before the deal was closed (R. 100), and during that time approximately 20 trips were made by them from Seattle to Portland (R. 100), these trips taking up to 2 days each (R. 128). All three negotiated actively and their labors were approximately equal (R. 117, 118).

4. The transaction was finally closed on the basis of the owner's executing and delivering to Maltby a 15-year lease having a minimum rent of $7,000.00 per month with provision for additional percentage rent, and having among other things a provision permitting assignment to Multnomah as an operating corporation on condition that the majority of the personnel of Multnomah would be the same as that of Maltby and Western (R. 71, 72, 73). The principal executive officers of Multnomah on the date of the assignment were: S. W. Thurston, President; F. A. Dupar, Secretary, and Peter G. Schmidt, Treasurer (R. 35). These individuals had had long experience as hotel operators

(R. 99). As the lease required, these individuals, officers of Multnomah, were the same as the principal officers of Maltby and Western (R. 34, 37), except that in later years one F. M. Kenney, who represented PCI, (R. 39), replaced Mr. Schmidt as an officer of Western (R. 37). This personnel factor governed the deal so far as Hauser Securities Company was concerned (R. 129), and in this connection the original lease contains the following recital:

> "This lease to a large extent is based upon the personnel of the present officers of said lessee and their ability to conduct and operate a first-class hotel, and by reason thereof lessee covenants and agrees not to assign this lease nor sublet nor underlet nor permit any other person or persons to occupy said premises . . ."
>
> "Provided, further, that it is understood and agreed that the within lessee contemplates the forming of an Oregon corporation to whom the within lease may be assigned by it, the majority of the personnel of which will be the same as that of the within named lessee and/or Western Hotels, Inc. . . ."

The Multnomah lease further required security for performance of the lease covenants and Maltby, PCI and Dupar, the payees of the money here in question, furnished this security in the form of guarantees and in the case of Maltby, a transfer of its stock (R. 104). This security was furnished 25% by Dupar, 25% by PCI and 50% by Maltby (R. 129, 130). It was essentially a suretyship of the taxpayer's leasehold obligations by these three stockholders of taxpayer, and tax-

payer eventually reimbursed them for their outlay of principal (R. 104, 105).

5. Collateral to the negotiations of the basic lease with Hauser Securities Company and the arranging for its assignment to Multnomah, there was a negotiation by Dupar, Maltby and PCI for a consideration to be paid to them, but not the other stockholders of Multnomah. This payment was to be made by Multnomah. The amount eventually settled upon was a monthly payment of $2,500.00, $625.00 of which was to go to F. A. Dupar, $625.00 to PCI and $1,250.00 to Maltby. These payments are the subject of this law suit. The payments were understood to be conditioned upon there being sufficient earnings to make them (R. 137). They were in fact made in the amounts stated with the exception of certain interruptions during depression years. No part of them was shared by the recipients with any other stockholders of Multnomah (R. 105).

The basic lease by its own terms was to expire in 1946, but in 1944 a 15-year extension was renegotiated (Ex. 3, R. 81). At that time there was very serious concern over post-war conditions due to predicted depressions (R. 107), the prospect of serious competition (R. 111), and the need for spending a large sum of money to rehabilitate the hotel which had run down because of priority restrictions and war-time regulations (R. 108). Hauser Securities Company was insistent that the same personnel provisions be included in any extension (R. 111). As finally negotiated, the new lease raised the basic rental (which had priority over the payments here in question) to $8,500.00, which was done with the agreement of F. A. Dupar, PCI and Maltby, although

they had two and one-half years to go under their payment agreement, and although it was felt by these three, from their personal standpoint, that they "were signing up with the Hausers for another 15 years and that (they) would have to stay with them and not get into negotiations on a new hotel with other people" (R. 112).

The supplemental payments to Dupar, Maltby and PCI were extended by written agreement which bears the signature of all three (although Dupar and Schmidt signed as having accepted it rather than as a party) (Ex. 5, R. 82). This agreement provides in part:

> "Whereas on June 17, 1931, an indenture of lease was entered into between Hauser Securities Company . . . and Maltby-Thurston Hotels, Inc. . . . which lease was negotiated by Maltby-Thurston Hotels, Inc. by and with the participation and assistance of Peter G. Schmidt, Trustee, and Frank A. Dupar; . . .
>
> "Whereas, said lease, unless otherwise extended, would by its terms terminate on July 1, 1946, and the parties are desirous of securing an extension of said lease, and such extension has been negotiated by and with the assistance of Maltby-Thurston Hotels, Inc., Peter G. Schmidt, Trustee, and Frank A. Dupar, and such extended lease provided for the minimum rentals to be paid thereunder in larger amounts than previously, and that such rental provisions are to take effect as of February 1, 1944, rather than to await the expiration of the original term of said lease, all of which has been consented to by Maltby-Thurston Hotels, Inc., Peter G. Schmidt, Trustee, and Frank A. Dupar, whose payments from Multnomah Operating Company may be affected thereby; . . .

"2 (Multnomah) agrees that one of the considerations by which it was able to secure the extension and amendment of said lease was the assurance . . . that the provisions . . . of the original lease would be continued in force with respect to the covenant that the majority of the personnel of (Multnomah) would be the same as that of Maltby-Thurston Hotels, Inc., and/or Western Hotels, Inc. . . .

"3. The party of the second part (Multnomah) agrees that the extension of said lease has been procured through the efforts of personnel of Maltby-Thurston Hotels, Inc. and of Western Hotels, Inc. with personal assistance of Frank A. Dupar and S. W. Thurston. In consideration of procuring such extension and in consideration of the other covenants, terms and provisions of this agreement, Multnomah Operating Company agrees that the monthly payment of $2,500.00, which was the consideration for the assignment of said lease, shall continue to the end of the full extended term . . ."

6. The three "payees," Maltby, PCI and Dupar, have sometimes referred to their payments as rent (See e.g. R. 135), but during the trial there was a demonstrated uncertainty about the correct characterization of this income (R. 114, 134, 135). The witnesses at the trial, Dupar and Thurston, described in detail the underlying motivation for demanding and receiving the payments, as well as the factual background which they thought justified them. The following circumstances bear on this point. A great deal of time and effort was expended by Dupar, PCI and Maltby in organizing the venture (R. 99, 100, 117, 118,

128). Multnomah Hotel was in extremely bad financial condition in 1931, and its prospects for improvement were questionable (R. 105). In addition, the property was badly run down and needed large outlays of capital for rehabilitating it (R. 99, 106), which was likely to drain off all the operating revenues from the property (R. 106). Two of the three payees were in the position of being minority stockholders in Multnomah (R. 26), with no control over operating expenditures, and it was particularly feared by Dupar (R. 106) that this might result in their not getting a return for their work in the transaction (R. 102). Furthermore, as previously stated, the lease was conditioned upon Multnomah obtaining and keeping the same personnel as Maltby and Western, these being Dupar, Thurston, who was the representative of Maltby, and Schmidt, who was the representative of PCI. Also, these three individuals were required to guarantee up to a stated amount on the purchase price of stock to be deposited as collateral security for performance of the lease covenants. There was thought to be great risk in the venture (R. 124) both at the time of the original lease (R. 105) and the 1944 extension (R. 111). Taxes were not considered and were not a motivation for the payments (R. 106).

Throughout their testimony, witnesses Dupar and Thurston repeatedly described the payments from taxpayer as being an earned payment for their work and services in the Multnomah Hotel venture (R. 102, 106, 131, 132, 134, 137).

7. On the subject of compensation, the Tax Court in its memorandum decision found as follows:

"... In the light of the testimony of Dupar and S. W. Thurston, who represented Maltby in all the transactions here involved, it is clear that the basis for the payments was services rendered by the three payees prior to the execution of the original lease in 1931 and also prior to the execution of the renewal agreement in 1944, and for services to be rendered thereafter during the term of the lease and its renewal."

"We are impressed, ... that this record fully substantiates the conclusion that whatever the petitioner has named the amounts sought to be deducted, they were compensation for services rendered in the ordinary course of petitioner's business within the meaning of Sec. 23(a)(1)(A).... We think that in the light of the long experience of all three payees in the hotel business and in view of their efforts in negotiation of the original lease and the efforts of Dupar and Maltby in the negotiation of the renewal thereof, together with other services required of one or the other of them during the lease and its extension and agreements in pursuance thereof, such compensation was not unreasonable...."

SUMMARY OF ARGUMENT

1. The burden is on appellant to prove that the Tax Court was "clearly in error," and by applicable statute, rules of procedure and this court's own decisions, the decision below must be upheld unless that burden is met. The question of whether the payments were made as compensation, reasonable in amount, is one of fact for the trial court, and great weight must be given to the trial court's opportunity to evaluate the credibility of witnesses.

2. There is no merit in the contention that the Tax Court, as a matter of procedure, was not entitled to find that the payments were deductible as compensation under Sec. 23(a)(1)(A) of the Internal Revenue Code. There was actually no new issue "injected in the case," because the fact that the taxpayers as laymen sometimes referred to the payment as rental payments for their services rather than compensation payments for their services, does not in any way alter the circumstance that they *were* payment for services, which is the ultimate fact that creates and controls the tax situation as was found by the Tax Court. In any event, the Tax Court is entitled to decide the case upon the facts of record so long as it does not rely upon facts not so established. It is on this ground that the authorities cited by petitioner are readily distinguishable. This is an unusually complete record of the transaction, and it is particularly important to note that petitioner was either unwilling or unable to suggest in its motion for rehearing, amendment to motion or brief on appeal, what evidence it could produce to amplify the present record if the case were reopened. The counsel for the Commissioner had and used the opportunity to make a searching cross-examination of the witness on all of the testimony relied upon by the Tax Court, and in addition, all of the detailed evidence concerning the services and undertakings rendered to taxpayer by the three payees was admitted without objection or exception.

3. In addition to supplying the required "substantial evidence," this record affirmatively and compellingly demonstrates that the Tax Court was correct in its decision. At the time of the original lease the three

payees rendered extensive and valuable services in securing the lease and establishing the Mulnomah Hotel as a going business. This took place in the bottom of the depression of the 1930's, when the hotel was badly run down, physically and financially, and the venture was attended by great risk. In addition to these services, the three payees, as individuals, were obliged to pledge their personal credit to secure performance of the lease by taxpayer up to an aggregate amount of $75,000.00, which was a very substantial sum in those days, particularly in view of the financial condition of the payees themselves. These guarantees were by direct payments, for which they were ultimately reimbursed to the extent of the principal outlay. In addition, Messrs. Dupar and Thurston, two of the three payees, consistently throughout their testimony, referred to the disputed payments as being received by them in exchange for their services and undertakings. A further factor is that the landlord not only in 1931 but also at the time of the 1944 extension, insisted that they be maintained by taxpayer as its chief executive officers, which insistence was manifested in a specific lease covenant on the subject. The taxpayer agreed with the landlord in writing to maintain this personnel, and they in fact stayed on throughout the entire period involved in this case. Also before the Tax Court in support of its decision were the circumstances existing at the time of the 1944 extension. At that time the three payees, who still had two and a half years to go on their payments, acceded to a novation of the lease at an increased basic rental, which was understood to have priority over their own payments, even though there was grave con-

cern about the future because of predicted post-war depressions, the threat of serious competition, and the need for extensive capital outlays to rehabilitate the hotel which had badly run down during the war. In agreeing to this extension the payees regarded that from their personal standpoint they were foreclosing themselves from going into any other hotel ventures in the Portland area and that the extension committed them to stay with the Multnomah for an additional 15 years. Taken together, the evidence concerning the efforts and undertakings of the three payees on behalf of taxpayer, affirmatively sustains the ruling of the court below, which is made even more apparent in view of the principles of law under which such evidence must be evaluated.

4. The payments in question were not dividends and to so hold would require a strained and distorted interpretation of the facts. The appellant's argument in characterizing these payments as dividends is apparently based on two points, the first of which is in error on the facts, and the second a *non sequitur*. First, it is said that the payments were made in proportion to the stockholdings. This is manifestly not true, because Dupar, who owned less than 7% of taxpayer, negotiated for and secured 25% of the total payments in question, none of which was shared with minority stockholders. The latter were from time to time fiduciaries who cannot be presumed to have given up their right to demand a ratable share of any "dividend" that taxpayer paid. The second point is that the payments were negotiated so that the three payees would have a fixed or guaranteed return from the business. While an accu-

rate statement of fact insofar as it identifies one of the motivations for these payments it has no force as identifying the payments as dividends. Indeed, the idea of a fixed charge or payment is altogether consistent with the idea of compensation, but is inconsistent with its being a dividend, a dividend by definition being contingent upon earnings.

5. This arrangement was not made for the purpose of tax avoidance. It has a legitimate business purpose. Whatever the payees may have called the disputed payments, there can be no question that they were at all times paid—and thought of as being paid—in exchange for the services, efforts and undertakings of these individuals for and on behalf of the taxpayer. The record thus presented admits of no other conclusion than that the Tax Court's decision must be sustained.

ARGUMENT

1. The scope of review prescribed by statute and this court's own decision requires that the Tax Court findings be sustained unless they are clearly erroneous. The burden of proof is on appellant.

A. The review of the Tax Court decision is to a large extent a factual rather than a legal problem, and for that reason as well as because of the references in appellant's brief to burden of proof, it would be advisable to set forth briefly the rules which govern the scope of review on appeal.

B. 26 USC 7482 vests in the Court of Appeals the exclusive jurisdiction to review the decisions of the Tax Court and establishes that this be done, ". . . in the same manner and to the same extent as decisions of

the District Courts in civil actions tried without a jury; . . .".

Supplementing this is Rule 52(a) Federal Rules of Civil Procedure which enjoins that findings of fact shall not be set aside unless clearly erroneous, ". . . and due regard shall be given to the opportunity of the trial court to judge the credibility of witnesses."

This court has on several occasions examined these precepts. *Grace Bros. v. Commissioner of Internal Revenue,* 9 Cir. 173 F.2d 170; *Maloney, Collector of Internal Revenue v. Hammond,* 9 Cir. 176 F.2d 780; *Cohn v. Commissioner of Internal Revenue,* 9 Cir. 226 F.2d 22. In the *Maloney* case, *supra,* it said:

> "On this question the trial court found in favor of appellee. In such a situation we have the duty of sustaining the findings of the trial court unless it is clearly erroneous."

Even where the facts are stipulated as a substantial portion of them are in this case, this court will not disturb the findings of the Tax Court unless clearly erroneous, the reason being that stipulated facts are susceptible to inference and the lower court has the legitimate function of making such inferences. *Rollingwood Corp. v. Commissioner of Internal Revenue,* 9 Cir. 190 F.2d 263. The determination of whether a payment constitutes compensation for services, reasonable in the circumstances, is one of fact for the trial court. *Doernbecher Mfg. Co. v. Commissioner of Internal Revenue,* 9 Cir. 95 F.2d 296 *Vita-Food Corp. v. Commissioner of Internal Revenue,* 9 Cir. 238 F.2d 359; *J. H. Robinson Truck Lines v. Commissioner of Internal Revenue,* 5 Cir. 183 F.2d 739. The rule applies to

ultimate facts as well as evidentiary facts. *Burns v. Commissioner of Internal Revenue,* 177 F.2d 739.

Finally, and of signal importance in this proceeding is the well-settled rule that on appeal the *appellant* has the burden of proving that the Tax Court's findings are clearly erroneous and not supported by substantial evidence. *Grace Bros., Inc. v. Commissioner of Internal Revenue, (supra).*

2. The Tax Court acted well within its authority in deciding this case on the grounds ascribed to the decision.

A. Appellant argues that it was over-reached by the Tax Court, which on the review of the record held that the payments in question were deductible under Sec. 23(a)(1)(A) of the Internal Revenue Code of 1939 as compensation paid in the ordinary course of business. We think that this argument is specious for a number of reasons, but preliminarily it should be noted that neither in its motion for rehearing, amended motion or brief on appeal, did appellant give any suggestion of what evidence could be added to that already in the record to amplify the transactions in question. The clear implication of this is that appellant has no material additions to suggest which becomes even more clear upon examination of the record.

On an appeal from a decision of the Tax Court a similar contention was made by an unsuccessful litigant in *Anderson v. Commissioner of Internal Revenue,* 2 Cir. 156 F.2d 591. After reviewing the point at length, Judge Swan in his concurring opinion upheld the lower court stating the rule that:

> "It is well settled that a decision may be sustained on a new legal theory where 'no facts not already of record are required for decision. *Commissioner v. Hopkinsson,* 2 Cir. 126 F.2d 406, 409; *Alexander Sprunt & Son v. Commissioner,* 4 Cir. 64 F.2d 424, 427; *Helvering v. Gowran,* 302 U.S. 238, 246, 58 S.Ct. 154, 82 L.ed. 224."

In *Moore et al v. Commissioner of Internal Revenue,* 5 Cir. 202 F.2d 45, 47, the court analyzed a similar contention, but one in which the appellant (unlike appellant here) set forth additional facts it claimed it would prove if the record were reopened for additional evidence. The court upheld the trial court saying:

> "We agree with respondent that the procedural point is without merit. This is because the time for petitioners to have made it was when the matter was first raised below. *It is because, too, the record as made below already contains all matter material to the issue. The five additional items of evidence which they say they can and will offer on rehearing are either already sufficiently disclosed in the record or are without real bearing on the determination of the issue."* (Emphasis supplied)

In essence, the appellant's point is that the Commissioner of Internal Revenue was denied the chance to put in new evidence, yet this contention is a naked ex-parte statement, unsupported by the slightest indication of what it could prove if the record were reopened, or what evidence there might be on this transaction other than that already reported. In the circumstances, the Tax Court, in a proper exercise of its discretion, denied the motion for rehearing, and by implication found no prejudice to appellant, which view is altogether supported by the present record.

B. The court can see that this record is unusually complete in all details of the transaction, including relationships, documents, motives, events and chronology. No documentary evidence that is material was omitted. The stipulation entered into between the parties covers the officer, director and stockholder relationships between the individuals and corporations in unusual detail. In addition, F. A. Dupar and S. W. Thurston appeared as witnesses at the trial and were exposed to a thorough cross-examination which consumed as many pages of the record as the direct. In fact, it was during this cross-examination that a good deal of the evidence in support of the Tax Court's ruling was developed (R. 117, 134, 137, 139).

This court should note particularly that counsel for the Commissioner of Internal Revenue offered no objection or reserved no exception to the admission of detailed testimony of Messrs. Dupar and Thurston regarding the amount of work done by the three "payees," their motivation for demanding these payments, their undertakings, their chances of success, their risks, or the fact that they considered the money to be a return for their personal efforts, all of which testimony supports the decision of the Tax Court.

The record discloses, in the testimony of Messrs. Dupar and Thurston, that the payments received from Multnomah were consistently regarded and described as being earned payments for their work and services in the Multnomah Hotel venture (R. 102, 106, 131, 132, 134, 137). Prior to the original lease, Maltby, PCI and Dupar negotiated continuously for between ten months

and a year before the deal was closed (R. 100), and during that time approximately twenty trips were made by them from Seattle to Portland (R. 100), these trips taking up to two days each. All three negotiated actively and their labors were approximately equal (R. 117, 118). The venture was undertaken in a period of great uncertainty, when the hotel was in extremely bad financial condition (R. 105) and when the property was badly run down and needed large outlays of capital for rehabilitating it (R. 99, 106). There was thought to be great risk in the venture (R. 124), both at the time of the original lease (R. 105) and of the 1944 extension (R. 111). At the time of the 1944 extension, these individuals had two and one-half years to go before their payments ran out; yet they agreed to the extension, even though it increased the basic lease rental to $8,500.00 a month, which had priority over their payments, and was made at a time when serious concern existed over post-war conditions, due to predicted depressions (R. 107), the prospect of serious competition (R. 111), and the need to spend a large sum of money to rehabilitate the hotel, which had run down because of war-time material and labor restrictions (R. 108).

In addition to the work done and risk involved in negotiating the Multnomah lease and its extension, Dupar, PCI and Maltby were required to guarantee the original leasehold obligations of taxpayer (R. 129, 130), under an arrangement wherein $75,000.00 of preferred stock in Maltby was bought by them and advanced to taxpayer to secure performance of their lease.

These individuals had had long experience as hotel

operators and the owner of the building considered that "... the personnel factor governed the deal" (R. 129). In the original lease it was recited that the lease "is to a large extent based upon the personnel of the present officers of said lessee," and that "it is understood and agreed that the within lessee contemplates the forming of an Oregon corporation to whom the within lease may be assigned by it, the majority of the personnel of which will be the same as that of the within named lessee and/or Western Hotels, Inc., ..." The same provision governed the 1944 extension, as is evidenced by Exhibit 5 (R. 92), and the testimony of the witnesses during the trial (R. 129). Witness Dupar testified that, viewed from their personal standpoint, they "were signing up with the Hausers for another fifteen years and that (they) would have to stay with them and not get into negotiations on a new hotel with other people" (R. 112).

At page 106 of the record, it was stated:

> "Q. Did you consider that your services in connection with the negotiations of that lease justified the payment which was required?
>
> A. Yes, I did.
>
> Q. Did you have in mind any questions of the effect tax-wise upon Multnomah Operating Company?
>
> A. Taxes were a very small matter in those days. I don't remember what the tax rate was, but I don't think it was over ten per cent."

There was thorough examination and cross-examination of the witnesses on all of these points and it is difficult to visualize how any amplification could be mate-

rial, particularly since the inquiry here is limited to whether the findings of the Tax Court are sustained by substantial evidence, rather than whether taxpayer has met his burden of proof.

C. In *Anderson v. Commissioner of Internal Revenue,* (*supra*), the test invoked to determine whether the Tax Court went beyond its authority was whether its decision was based on facts *other than those which appear in the record.* This test would seem particularly applicable here, where the record is complete, where the evidence supporting the trial court's decision was admitted without objection, where full cross-examination was made and where the appellant is unwilling or unable to point out how the record could be amplified.

Standing in contradistinction is the case of *Standard Galvanizing Company v. Commissioner of Internal Revenue,* 7 Cir. 202, F.2d 736, quoted in part and relied on by appellant, wherein the Circuit Court reversed and remanded a case to the Tax Court. There the Tax Court had examined whether an item of attorneys' fees was deductible as being a necessary expense incurred in the ordinary course of business. The fees were incurred in litigating the case of an officer who had pledged personal securities to obtain a loan for the taxpayer and who was subsequently sued on the debt. The question presented to the Tax Court was whether the taxpayer was required to enter into this litigation by virtue of the fact that the officer had acted on behalf of the taxpayer in procuring the loan. Although the theory was thus based on contract, and although there was no evidence whatsoever on the question, the Tax

Court disallowed deduction on the gratuitous theory that the officer had been *negligent,* which negligence exonerated the taxpayer.

The exact opposite is present in this case, because the court had before it a full record in which the payments to Maltby, Dupar and PCI were repeatedly identified as payments made in exchange for their services in negotiating the hotel lease and its extension and their other undertakings in regard to the lease and operation of the hotel properties.

D. Moreover, an analysis of this case shows that the appellant is incorrect in its basic assumption that the Tax Court "injected a new issue" in the case when it held that Multnomah was entitled to deduct the Dupar, Maltby and PCI payments as compensation under Sec. 23(a)(1)(A). The law which the Tax Court has applied is the same section of the Internal Revenue Code that was relied upon by taxpayer throughout. The identical activities by Dupar, Maltby and PCI with regard to negotiating the hotel lease and performing other services, gave rise to both the claim by the Multnomah that the payments were a proper deduction against its income tax as a business expense, and the holding by the Tax Court that the Multnomah should be allowed to deduct them as a business expense. The money payments held to be deductible were the same as those claimed by the taxpayer as a deduction. No new amounts were involved. The same tax years and the same persons were involved throughout.

In identifying the payments as *rent* payments for services rather than *compensation* payments for serv-

ices, the taxpayer does nothing to change the fact that they were payments for services and that fact is what creates and controls the taxable event as the Tax Court held below. It seems to us that appellant is making a purely semantical argument in its use of expressions such as "injected a new theory in the case." To illustrate this further we point out that the situation here is not like that presented in *Standard Galvanizing Company v. Commissioner of Internal Revenue,* (*supra*), on which appellant relies, where the issue raised was that of a contractual relationship and where the decision was based on a theory of negligence arising out of collateral facts not even in evidence.

It is well settled that a taxpayer cannot establish or alter the tax consequences of a given transaction by merely using a name. *Commissioner of Internal Revenue v. Schmoll Fils Associated,* 2 Cir. 110 F.2d 611; *Jewell Tea Co. v. U.S.,* 2 Cir. 90 F.2d 451; *U.S. v. Southern Georgia Railway Company,* 5 Cir. 107 F.2d 3; *Jordan Co. v. Allen,* USDC Ga. 85 F.Supp. 437.

E. According to our research it is in any event settled law that an appellate court has the power to apply any theory supported by the record to sustain a lower court's decision where the lower court reached a correct result under the facts of the case. *Hormell v. Helvering,* 312 U.S. 552, 61 S.Ct. 718, 85 L.ed. 1037; *Rhodes v. Commissioner of Internal Revenue,* 111 F.2d 53; *Helvering v. Gowran,* 302 U.S. 238, 58 S.Ct. 154, 82 L.ed. 224. In the *Rhodes* case, *supra,* the Court of Appeals for the 4th Circuit stated the rule in a very thorough opinion as follows:

> "This latter rule seems to be that an appellee may urge or the appellant court on its own motion may consider any theory, argument or reason in support of a decision of a lower court or board irrespective of whether or not such theory, argument or reason was relied upon or even considered by or suggested to the court below. . . ."

It would be manifestly improper to disturb the findings of the Tax Court, when appellant cannot point out how the record is incomplete, where he had ample chance to cross-examine the witnesses on all points presented, where testimony in support of the Tax Court decision was admitted without objection, where the record as it stands is unusually complete, where the Tax Court patently based its decision on facts of record, and where the decision did not in fact raise any novel issue.

3. There is substantial and compelling evidence to sustain the Tax Court finding that the payments in question to Dupar, Maltby and PCI were reasonable compensation for their service.

The analysis under this heading is primarily a factual analysis, because the only question before the court is that of determining whether the decision of the Tax Court is supported by substantial evidence insofar as it found that the disputed payments to Maltby, Dupar and PCI, by taxpayer, were compensation for services rendered. The Tax Court had before it an unusually complete and detailed record of the labors of these three in securing the original lease and its 1944 extension, of their efforts in organizing the hotel venture, of their

guaranteeing the performance of the original lease covenants, of their remaining as executive personnel of taxpayer corporation throughout at the insistence of the landlord, of the conditions and adversities that faced them both in 1931 and 1944, of their successful development of the business, and other evidence which clearly sustains the decision of the Tax Court.

After review of this record, the Tax Court found:

> " . . . In the light of the testimony of Dupar and S. W. Thurston, who represented Maltby in all the transactions here involved, it is clear that the basis for the payments was services rendered by the three payees prior to execution of the original lease in 1931, and also prior to the execution of the renewal agreement in 1944, and for services to be rendered thereafter during the terms of the lease and its renewal. . . . " (R. 46)

It is now the position of appellant that this finding was arbitrary and capricious, and in any event not supported by substantial evidence. We submit that the record is such that it affirmatively shows the Tax Court to be correct, let alone supplying the substantial evidence which renders the lower court's findings inviolate.

A. In the first place, the record shows that in the period 1930-1931 when this venture was undertaken, Maltby, Dupar, and PCI expended an enormous amount of work and effort in securing possession of the property. This work was not confined to a lease negotiation, but actually embraced the development of an important hotel business at a time when the national economy was declining into the depression of the 1930's and also at a time when the hotel was badly run down

and losing money. The atmosphere was one of great concern over the high risk involved.

Mr. Dupar testified at pages 105, 106 of the record:

"Q. With respect to Multnomah Operating Company as of 1931, what was your then anticipate of the earning prospects of the company?

A. Well, we really didn't expect to get all our lease rent.

Q. Pardon me?

A. I say, we did not expect to get the $30,000.00 even, we didn't think it would make that much.

Q Why was that?

A. Well, as I say, we were in the depression and it was getting worse every day. Our business was going down, our volume was going down. That continued for, well, right into '32.

Q. Well, what was the condition of the property as to its requirements with respect to maintenance?

A. It was in a very dilapidated condition. The lobby was just shameful, I thought. The rooms upstairs were perhaps 250 without baths. The furniture was old, the carpets were old, it needed a great deal of work, a great deal of money spent on it."

The negotiation was carried on by Mr. Dupar, Mr. Peter G. Schmidt (representing PCI) and Mr. S. W. Thurston (representing Maltby), for a period of time extending over ten months to a year (R. 100, 128), all three constantly traveled from Seattle, Washington, to Portland, Oregon. Witness Dupar testified that in doing this they went down twenty-five times (R. 100) which is corrobroated by the testimony of S. W. Thurston, who recollected having had between "twenty and

thirty'' meetings which lasted from ''half a day to two or three days'' (R. 128). Their labors were approximately equal (R. 117, 118). As a result of these efforts the Multnomah lease was eventually secured from Hauser Securities Company, the building owner, and taxpayer went into possession of the hotel. The hotel was eventually developed into a prosperous business (R. 11) through the continued efforts of the payees, as officers and directors of taxpayer.

We submit that on the basis of hindsight, which seems to be the basis which the Commissioner has repeatedly used in viewing this transaction, the above facts alone would support a much higher compensation than was in fact paid to Maltby, PCI and Dupar. In this connection we cannot resist quoting from Regulation 111 insofar as it sets out an express injunction to evaluate arrangements such as this from the circumstances as they existed when the contract was made rather than the circumstances present when the contract is challenged.

> '' . . . The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date the contract is questioned.'' Reg. 111, Sec. 29.23 (a)-6(3).

B. In addition to securing the property and organizing the venture, Dupar, PCI and Maltby, on behalf of Multnomah, agreed to pledge their personal credit up to $75,000.00 to guarantee the taxpayer's performance of the lease covenants. On this point the Tax Court found (R. 41):

''The lessor required the deposit of security for

the performance by petitioner of the lease provisions. To that end Maltby issued to petitioner $75,000.00 of its preferred stock, which petitioner agreed to purchase. Petitioner in turn deposited the stock as security with the lessor. PCI through its trustee, Peter G. Schmidt, and Frank Dupar, each guaranteed to Maltby in writing that petitioner would pay the par value of 25% of such stock. Each was required at an undisclosed time to pay the amount so guaranteed for which payment each was substantially reimbursed by petitioner."

The testimony of F. A. Dupar on this subject appears on page 105 and 106 of the record. Witness Thurston described this arrangement as follows (R. 129):

"Q. Aside from the provisions of the lease itself, was there any requirement for the giving of security to the Hauser Securities Company?

A. There were seventy-five or seven hundred fifty shares of Maltby-Thurston preferred stock, it was put up by a security that was considered at that time to be worth $75,000.00.

Q. That was to be forfeited as liquidated damages in the event this lease was not carried out in accordance with its terms?

A. Correct.

Q. Who put that stock up?

A. Maltby-Thurston, half of it, half of it was put up by interests, Frank Dupar, including himself, the chief interested party, or a quarter, I mean, and a quarter by Peter Schmidt and the Pacific Coast Investment Company in their side of the picture.

Q. The stock was actually put up by your company, was it not, and they in effect guaranteed you against any loss, is that right?

A. Dupar interests and Schmidt Maltby-Thurston Company against loss of the quarter interest each that they had.

Q. Did they later make good on that guarantee?

A. They did. It was paid."

This guarantee of taxpayer's obligation by stockholders must also be considered in the light of the circumstances then existing to evaluate properly the scope of the undertaking. Multnomah had nine stockholders at the time (R. 26), but the guarantee was made by three of them, Maltby, Dupar and PCI. The amount was a very substantial sum in those days, particularly since the Maltby operation was one of great risk (R. 105, 106), and since Dupar himself "needed money as bad as anybody at that time" (R. 106), and Maltby was "in serious financial trouble, as good corporations were in 1931" (R. 102). In the circumstances the offering of the guarantee to taxpayer was a very valuable and substantial service, completely consistent with the Tax Court finding that Maltby, PCI and Dupar rendered and were compensated for their services and undertakings. It is on the other hand a factor most hard to reconcile with the Commissioner's analysis that the Multnomah's payments are distributions of profits, which they clearly were not.

C. Although sometimes referred to as rental payments for their services (R. 134, 135),[2] the court should

[2] The court should note that even during the trial there was a demonstrated uncertainty over nomenclature (although none whatever over the fact that the payments were regarded by the payees as an exchange for their services and undertaking). At record 134 Mr. Thurston testified, "A. I don't know how you would construe it. It was a lease between Multnomah Operating Company that required that payment. I don't know how you would refer to it unless it would be as a rental."

particularly note that witnesses Dupar and Thurston consistently and repeatedly testified that they thought of the payments as an earned exchange for the efforts, work and undertaking of the three payees in the Multnomah Hotel venture (R. 102, 106, 131, 132, 134, 137). At record 47 the Tax Court correctly observed:

> "We are impressed, however, that this record fully substantiates the conclusion that whatever the petitioner has named the amount sought to be deducted, they were compensation for services rendered in the ordinary course of petitioner's business within the meaning of Sec. 23(a)(1)(A) . . . "

By way of illustrating this point, it is pointed out that witness Thurston, the representative of one of the three payees of the disputed sums, testified (R. 131):

> "Q. Can you state whether or not that payment represented a fair compensation for the services and liability and responsibility which was involved?
>
> A. We felt it did at that time."

Further, he said in answer to a question on cross-examination as to how the division of payments was arrived at (R. 137):

> "Q. Isn't it correct that fifty per cent paid to Maltby-Thurston Hotels, Incorporated, and the twenty-five per cent paid to Peter Schmidt as trustee, were based on stockholdings in the petitioner?
>
> A. I don't recall having any agreement to that effect and I don't know that it was to that effect. I believe that it was predicated a great deal upon the services rendered. I know Mr. Dupar and my-

self and Mr. Schmidt in person rendered a great deal of services in these cases."

On direct examination, Mr. F. A. Dupar testified (R. 106):

"Q. Did you consider that your services in connection with the negotiation of that lease justified the payment which was required?

A. Yes, I did.

Q. Did you have in mind any questions of the effect taxwise upon Multnomah Operating Company?

A. Taxes were a very small matter in those days. I don't remember what the tax rate was, but I don't think it was over 10%."

He further testified at page 102 of the record:

" . . . My position was that I had very little of the stock. I was just a minority stockholder. I had done all the work, I was entitled to something, and I hung out for a lease that would pay me something.

THE COURT: You had done all what work?

THE WITNESS: Negotiating the, negotiating the lease with the Hausers which took several months."

Also in regard to the situation in 1944 when the three payees consented to go along with the extension of the hotel lease, Dupar testified (R. 111):

"Q. In 1944 when you made your commitment on the basis of the extended lease, did you feel that you were in any way prejudicing your personal position by continuing the arrangement, that is, that the participants were?

A. We felt that we had, we were signing up with the Hausers for another 15 years and that we

would have to stay with them and not get into negotiations on a new hotel with other people."

The payments made by taxpayer were clearly regarded by them as exchange for what they had done as individuals, and this fact is very significant in this review because the concept of payment for services is entirely consistent with the findings of the Tax Court, whereas it is entirely inconsistent with the Commissioner's theory that they were dividends. Appellant attaches some importance to the fact that witnesses Dupar and Thurston, although laymen, identified the returns for their efforts as rents, but it is respectfully submitted that to the extent they did employ the expression "rental," their entire testimony about insisting on the payments in exchange for services is greatly enhanced in credibility, as there could have been no subjective predisposition by the witnesses to substantiate them as salaries. Such considerations as this are the distinct province of the Tax Court in evaluating witnesses before it. Rule 52(a) Federal Rules of Civil Procedure.

D. Also giving credence to the Tax Court decision is the fact that the taxpayer was required to and did maintain the three payees on its staff as principal executive officers during all times involved in this action. Dupar and Thurston, representing Maltby, and Schmidt, representing PCI, occupied the chief executive posts in Multnomah through the entire period 1931 to 1949, except that in the 1940's F. M. Kenney replaced Schmidt as the representative of PCI, he having taken over the Presidency of that corporation (R. 35, 36, 37). This fact was not disputed by the Commissioner.

Both at the time of the original lease and the 1944 extension agreement, Hauser Securities Company, the owner of the hotel property, insisted that they be kept on, and this insistence was imposed as a condition to turning the hotel over to Multnomah (R. 128, 129). It was even carried to the point of being written into the lease as a lease covenant (Ex. 1, R. 72), which this court will agree is an unusual manifestation of concern on the point, viewed from the standpoint of how businessmen normally arrange such affairs. The situation in this regard is well illustrated by the testimony of Mr. Thurston (R. 129):

> "Q. Did the Hausers make any requirements in that respect?
>
> A. They did very definitely, and I believe it was written into the lease, if I remember right, that the same personnel must be maintained, and the lease was taken by the Maltby-Thurston Company and transferred into an operating company, and in that operating, or in that assignment was a definite condition that we had to maintain the personnel and the contacts."

This is supported by Mr. Dupar, who in describing the situation in 1944, said (R. 111):

> "A. Eric Hauser, who represented the owners in most of the negotiations, was very particular on the point of who was going to run the hotel. He said as long as the Western, the same personnel as is now in the Western, run, own and operate the Multnomah Hotel, he was willing to give us this extension. And I think if we transferred to another corporation that the lease could be validated or made invalid."

The taxpayer expressly assumed the lease covenant

regarding maintenance of the same personnel, in both the instruments assigning to it the original lease (R. 78), and the 1944 extension, and recognized it as a legal obligation in the written contract which extended the payments in question to the three payees (Ex. 5, R. 92). The 1944 extension (Ex. 3, R. 81) was actually a novation of the lease and ran directly to taxpayer without any intervening assignment; and in such form imposed the personnel requirement directly on taxpayer (R. 85).

Although collateral to the issue, we wish to point out that the Commissioner has attempted to minimize the significance of this personnel requirement as evidence of the contribution by the three payees to Multnomah by arguing that they were not the persons Hauser Securities Company had in mind, the Commissioner's theory being that the lease covenants provided that the Multnomah be staffed by the principal personnel of Western and Maltby, rather than the three payees identified by name. It should be noted that the three payees were actually the President, Vice-President and Secretary, respectively, of Western (R. 37) throughout the entire period involved in this case, and, with the exception of Schmidt, they were also the chief executive officers of Maltby, which added to the fact that for 17 years Hauser claimed no dissatisfaction with the arrangement would seem to remove any question as to whether they were the operating personnel the landlord had specified.

The important point to be kept in mind in evaluating the contribution of the three payees to taxpayer, is that they procured the lease and organized the hotel busi-

ness at a time when the hotel was physically and financially run down, and over a period of years thereafter developed it into a sound and prosperous business (R. 10, 11). The owner's agreement to lease was at all times based upon their "ability to conduct and operate a first-class hotel" (R. 84), which he believed would reflect itself in increased rentals under the percentage rent arrangement. At the time of the original lease the three payees were experienced hotel operators (R. 99), and at the time of the lease extension in 1944, they brought to Multnomah and the owner an additional 13 years' experience of successful operations in the Multnomah Hotel itself.

There is a related consideration which the Tax Court could legitimately consider in its evaluation of these services. Hauser Securities Company insisted on having them and bargained for them at arm's length as a complete stranger to the transaction, which lends great weight to the finding that the services were in fact an important contribution to taxpayer. In view of the value of the Multnomah Hotel as a going business (which is evidenced by the fact that even in the 1930's it supported a basic rent of $7,000.00 per month (R. 70)),[3] it is utterly ridiculous to say—as the appellant seems to argue—that the amounts set out at R. 19, 20, constitute an adequate compensation to the three payees unless supplemented by the payments here in question. Even then, the compensation is modest by any reasonable standards.

E. A further line of evidence in support of the Tax

[3] See also R. 11 where in 1948 the net income before taxes was reported at $267,938.63.

Court finding in this case is the situation that existed at the time the 1944 extension was negotiated. These negotiations were carried out over a period of four years with the active participation of Dupar and Thurston (R. 107, 108). The new lease was granted on the express condition that the taxpayer maintain the same operating personnel as before. The three payees agreed to the extension (Ex. 5, R. 97) which included a substantially increased basic rent for the building, even though they had two and a half years to run on their own payments, which were generally understood to be subordinated to the basic lease rental. The situation at the time was one of grave and legitimate concern about the future of the business, because of predicted post-war depression (R. 107), a threat of serious competition (R. 111), and the need for very heavy expenditures to rehabilitate the hotel which had run down during the war years because of labor and material restrictions (R. 108). With these prospects before them, they considered that they had foreclosed themselves from going into any other hotel ventures in the Portland area by signing this extension, which is illustrated by the testimony of Mr. Dupar at page 111. In answer to the question of whether their commitment in any way prejudiced their personal position he said:

> "A. We felt that we had, we were signing up with the Hausers for another 15 years and that we would have to stay with them and not get into negotiations on a new hotel with other people."

Taken altogether, there is an abundance of evidence regarding (a) the efforts of the three payees at the time of the original lease, (b) their personal guarantees

and undertakings, (c) their continuous reference to these payments as a return for services, (d) their position as key men in the organization, (e) their efforts, undertakings and concessions in regard to the 1944 extension, (f) their experience and ability, and (g) their personal risk under the circumstances apparent at the time the payments were established.

We respectfully submit that the Tax Court decision is completely supported by this record, and under the limited question before this court—whether or not there is substantial evidence—the Tax Court decision must stand.[4]

4. The Tax Court found that the payments in question were not paid or received as dividends, and that finding is justified by compelling evidence.

To find that these payments constitute dividends requires a strained and unnatural interpretation of the evidence. Indeed, the entire theory of the Commissioner on this point (See pages 24-27 of appellant's brief),

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[4] Although primarily a factual question, the result is even more clearly indicated in the light of the legal principles which guide the analysis, including the following: (a) The determination of whether payments constitute compensation for services, reasonable in amount, is a fact question for the trial court. *Doernbecher Mfg. Co. v. Commissioner of Internal Revenue*, 95 F.2d 296; (b) It is proper for a taxpayer to allow compensation for services which were rendered in the past. *Lucas v. Ox Fibre Company*, 281 U.S. 115, 50 S.Ct. 273, 74 L.ed. 733; (c) where services are rendered to the taxpayer it is immaterial that the payments are made to stockholders, even where made in proportion to stockholdings (which is not the case here). *U. S. v. Reitmeyer*, 11 F.2d 648; (d) the situation must always be evaluated from the point of view of circumstances as they exist when the contract for payments was set up. Reg. 111, Sec. 29.23(a)-6(3); (e) the experience of those performing services has long been recognized as a factor in evaluating the reasonableness of what has been paid to them; (f) the factor of risk and uncertainty is also entitled to great weight in such evaluation. *Commercial Iron Works v. Commissioner of Internal Revenue* (5 Cir.) 166 F.2d 221.

boils down to two arguments, one of which is an erroneous statement of the facts, and the other a *non sequitur.*

A. It is first urged that the disputed payments were given in proportion to the stockholdings of the payees. Of course, this in and of itself does not make payments dividends, *United States v. Reitmeyer,* 11 F.2d 648, but even if it did the record clearly shows that Dupar, who owned less than a 7% interest in taxpayer corporation (R. 26), negotiated for and received personal payments equal to 25% of the total paid, none of which he shared with other minority stockholders (R. 105). It is important to note that the balance of these minority shares were owned at various times and in varying amounts by fiduciaries for decedents' estates and trustees (R. 26), none of whom received any portion of the payments here in question. One of these fiduciaries was Seattle-First National Bank as Trustee under the will of H. E. Dupar, deceased, an organization that cannot be presumed to have surrendered its prerogative to receive a proportionate part of any payments distributed by taxpayer as a dividend.

The stockholdings of the three payees in Western cannot be substituted for their stockholdings in taxpayer corporation, as appellant seeks to do, because Western was neither a parent nor a subsidiary, and none of the disputed payments were ever made to Western which got its compensation in the form of fees that are in no way involved in this case. So far as Maltby is concerned, appellant makes no such analogy, because in that case it would not work to the Commissioner's

advantage, Dupar having no stock ownership whatever until late in this period of events when he picked up small lots aggregating less than 4% of the total.

These payments were therefore not in proportion to the stockholdings of the payees, it being submitted that even if they were it would still not justify the Commissioner's contention that the payments were dividends under the facts of this case and the applicable law.

B. The Commissioner's second point is that the payments were demanded by the three payees so that they would be guaranteed a fixed return from the business to them as individuals. This fact is, of course, correct insofar as it shows the motivation of the payees who feared both at the time of the 1931 agreement and the 1944 extension that high expenditures would be required to rehabilitate the hotel and meet economic adversity (R. 102), and in the case of Dupar, that control over these expenditures would be reposed in the hands of two former bitter competitors who owned almost three-quarters of the stock between them. We fail to see how setting up these payments as a fixed charge in any way converts them into dividends or in any way alters the fact that they were demanded by reason of the efforts and undertakings of the payees in the Multnomah Hotel operation. Indeed, a contract to pay compensation *for services* is a fixed charge under any acceptable legal or accounting theory, but a dividend by its very definition is not. It must be constantly kept in mind, both as bearing on this question and as illustrating that the payments were set up by persons having antagonistic and dissimilar interests, that in 1931 when

the original lease was secured, the three payees had been "three very bitter competitors" (R. 98), two of whom were in a minority position. Because of the run-down condition of the hotel and need to rehabilitate it before it could be successfully operated, each of the minority shareholders faced an absolute control over expenditures by individuals who were his recent competitors, and this fact explains the insistence on having these payments; but we fail to see how it has any logical relation to the Commissioner's contention that it characterizes them as dividends.

CONCLUSION

The payments here in question have been made by the petitioner since the year 1931. They were continuously paid for a period of some 17 years before challenged by the respondent. While we recognize that the failure of the respondent to challenge the payments in previous years is not a bar to a later challenge, as in this instance, nevertheless it is indicative that so far as the Commissioner was concerned the payments were not such as to historically cause concern for their validity.

In practically every case where the Commissioner has been sustained in challenging payments, as non-deductible dividends, the circumstances have been such as to show that the payments made were essentially a plan or device for the purpose of avoiding taxes, which clearly is not the case here, under the testimony of Mr. Dupar that taxes were not even a factor when they were set up (R. 106), and in view of the clear and cogent evidence that they were received for the efforts and undertakings of the payees in setting up the original hotel operation and the 1944 extension.

Under the scope of review prescribed by this court's own decisions, the issue is in any event limited to determining whether the Tax Court was clearly erroneous, and on this subject the appellant has the burden of proof. By any reasonable standards the evidence in this unusually complete record not only supports the findings below in the sense of providing "substantial evidence," but affirmatively and compellingly demonstrates that the decision of the Tax Court was correct.

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